THE WALL STREET JOURNAL. ONLINE

ASIAN BUSINESS NEWS

Chinese Firm Studies Unocal Deal

China National Offshore May Want All or a Portion Of No. 9 U.S. Oil Company

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Staff Reporters of THE WALL STREET JOURNAL
January 7, 2005; Page A3

China's third-largest oil and natural-gas company is eyeing **Unocal** Corp., the ninth-largest oil company in the U.S. -- the latest sign of how China's search for oil, commodities and consumer markets is fueling Chinese acquisitions overseas.

The interest by China National Offshore Oil Corp. is highly preliminary, say people familiar with the matter, who add that there are no assurances a deal will ever be struck. It's unclear whether the company is interested in all or part of Unocal. The Chinese company's interest was reported yesterday on the Web site of the Financial Times.

Unocal is viewed as a likely takeover target. The El Segundo, Calif., company has amassed an attractive array of oil and gas assets in Southeast Asia, but is still considered relatively underpriced. After selling off its refineries and gas stations in 1997, the company has focused purely on exploration and production, generally considered the high-profit part of the oil industry. Unocal spokesman Barry Lane declined to discuss whether there had been any discussions with Cnooc.

"As a matter of policy, we don't comment on market speculation and rumors," he said.

The interest in Unocal comes at a time of growing Chinese investment overseas. Indeed, the notion that a Chinese state-owned company would be considering bidding for a publicly traded U.S. firm would have been largely unthinkable five years ago. But the booming Chinese economy -- and natural resources needed to sustain it -- have sent the country on an acquisition binge.

The country's managers still lack much of the financial and legal experience to put together a sophisticated transaction of the size of Unocal. While relying heavily on advice from U.S. and European banks and lawyers, the country is "handicapped by a cumbersome and time-consuming decision process on M&A," says Mason Cargill, an attorney at law firm Jones Day based in Shanghai. "In M&A, big decisions have to be made quickly."

Even with these limitations, Chinese companies have moved rapidly around the world to pursue different targets.

China and Canada are nearing a general agreement on Chinese investment in Canadian oil resources that could be signed as early as this month by the two governments. Among its few details is potential investment in Canada's so-called oil sands in the province of Alberta, an industry executive who has seen a draft of the pact said. The accord mentions China's three major oil companies -- **China National Petroleum** Corp., China Petrochemical Corp. and China National Offshore Oil -- each of which has expressed interest in taking stakes in oil-sands projects, the executive said. (See related article[1].)

Oil sands, gritty tar-like deposits that can be refined into crude oil, have largely been seen as a costly alternative to extraction from normal oil fields. But with improvements in technology and oil prices on world markets likely to remain high, refining oil from oil sands is becoming more commercially attractive, industry executives said.

Separately, China Minmetals Corp., the country's state-controlled trading giant, has been in talks to buy Canada's **Noranda** Inc., the world's third-largest zinc and ninth-largest copper producer, though those discussions have bogged down in recent months.

In Russia, Kremlin officials have said CNPC could become a minority investor in a new state oil company that would include Yuganskneftegaz, a big Siberian oil producer that by itself pumps about 1% of the world's crude, or about as much as Indonesia. Yugansk was a unit of OAO Yukos until Russian authorities forced a sale of the unit to cover $28 billion in back-tax claims against the former oil titan.

In Africa, China has purchased several blocks to explore for oil and gas and has set up refinery operations as well. In Sudan, it runs a major drilling operation that has become an increasingly crucial supplier to its domestic market, and a cash cow for the Sudanese government.

China recently signed a deal to rehabilitate old oil fields in Gabon in west Africa, an area where China has expertise thanks to declining production at its own oil fields. In Angola, it is providing the government with almost zero-interest loans in return for guaranteed oil sales while in South Africa. It has also formed a new joint venture that aims to create oil out of coal, and that company is now mulling an initial public offering to raise cash for additional investments.

In South America, Chinese interest has boomed as Chinese companies seek to secure new sources of oil, iron ore and other raw materials -- as well as new markets for their products. Excluding Hong Kong, Latin America attracts the largest volume of foreign direct investment from China, according to a November 2004 report by the United Nations Conference on Trade and Development, some $4.6 billion since 1993. That's still a pittance compared with the nearly $30 billion U.S., Japanese and European firms invest annually in Latin America, but the figure is expected to grow rapidly.

In September, two Sichuan companies signed an agreement to build China's biggest project in South America, a $160 million chemical plant.

China National Petroleum and China Petrochemical, known as Sinopec, have moved into Peru, making China the second biggest investor in the country's oil sector after Argentina. Both companies have also moved on to Ecuador and Venezuela.

Many oil-industry observers said Cnooc's interest in Unocal makes sense for both parties. Unocal has very attractive assets in Asia, but is considered too small a company to get the most out of them. The market has also considered Unocal a likely takeover target for awhile, in part because it's relatively undervalued in an otherwise expensive oil market -- at least until the stock shot up 7.7%, or $3.15, to $44.34, in 4 p.m. New York Stock Exchange composite trading on news of a potential acquisition.

"They were cheap this morning," says John Segner, manager of the AIM Energy Fund for AIM Investments. The fund held 290,000 shares at the end of September, the last time it publicly disclosed its holdings.

Unocal has a market value of $11.6 billion. Bernard Picchi, managing director of Foresight Research Solutions, says he thinks the company could fetch $54 a share, making it a potential $14 billion acquisition. If Cnooc offers less, he says it's possible another company could enter the fray.

Unocal has also been seen as a likely acquisition because of its size. Investors pushed the company either to get bigger and drive down their unit cost or get bought. While it has put together a string of profitable returns, getting bigger is tough because of the intense competition to find new fields. Other industry investors said the deal makes sense geographically, because most of Unocal's overseas assets are in Southeast Asia. "I've been telling people for a while that China would ultimately buy Unocal, I just didn't think it would be this soon," said Rodney Mitchell, president of the Mitchell Group, a Houston-based energy investment firm. "The whole thing just fits nicely."

--Charles Hutzler, Tamsin Carlisle, Joel Millman and Karby Leggett contributed to this article.